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Slice the paycheck pie based on needs

By Lynn N. Duke
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For most people their paycheck is their economic lifeline. Yet for all of its pull, many workers' paychecks have become less tangible in the past decade: a cyber transaction that puts no cold cash in their hands, yet allows them to live their lives and plan for their future.

How you allocate that income can make all the difference between living from paycheck to paycheck and building financial independence. And while there are no set rules about how to spend your pay, there are guidelines that apply to most people.

"The rule of thumb is 35 percent for housing, 15 percent for transportation, 15 percent for debt reduction, 25 percent for miscellaneous and 10 percent for savings," said Andrew Houser, co-CEO of Bills.com, a personal finance site geared toward consumer education.

The greatest variable in this mix is housing costs, according to Sandra Shore, a senior counselor at Novadebt, a non-profit credit-counseling firm.

"Housing costs are very different in different markets and people have different needs," Shore said. For example, one family might opt for a smaller house payment so that they can put their children in private schools, while another might be happy with public schools, allowing them a larger house payment.

And Shore said tracking your income and really understanding your expenses will help you divide your paycheck more effectively.

"Budgets are very individual," Shore said. "People get into trouble when they try to make their income fit into other people's budgets."

"Track your expenses for at least a month. Write down every penny you spend. Eighty percent of people don't know where most of their money is going."

One item that most people neglect in the budgeting process is debt reduction, which can quickly snowball out of control when only minimum monthly payments are made.

"If you have debt, consolidate it and get the lowest interest rate possible," said Pamela York Klainer, a senior advisor at Forte Capital LLC, in Rochester, N.Y. "You should be paying off your debt as aggressively as possible."

Workers should also enroll in their employer's retirement plan, and contribute as much as they can, or at least as much as their employer will match.

Setting aside money for emergencies is also an important financial goal, but should come after enrolling in a retirement savings plan and getting rid of your consumer debt, Houser said.

Being honest about needs and wants is key to building a budget you can live with.

"All of this is really about choices and tradeoffs," Klainer said. "Most of these things aren't financial decisions, they're lifestyle decisions."